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FISCAL IMPACT STATEMENT

LS 6136

BILL NUMBER: SB 42

NOTE PREPARED: Dec 3, 2014

BILL AMENDED:

SUBJECT: Administration of County Income Taxes.

FIRST AUTHOR: Sen. Kruse

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides that for taxable years beginning after December 31, 2015, a county imposing a local option income tax (LOIT) has the authority and responsibility for the administration, collection, and enforcement of the tax, rather than the Department of State Revenue (DOR).

The bill requires taxpayers to file county income tax returns with the county treasurer of the county that imposed the tax. It requires taxpayers to pay county income tax to the county treasurer of the county that imposed the tax. It provides that withholdings of county income taxes shall be remitted to the county treasurer of the county that imposed the tax.

The bill repeals provisions related to: (1) the state collection of county income taxes; and (2) the calculation and distribution by the state of certified distributions of county income taxes. It specifies that certain provisions related to the DOR's administration of state taxes also apply to a county administering a LOIT.

The bill provides that on February 1, 2016, and on November 1, 2016, the Auditor of State shall transfer to each county 95% of the balance on those dates of county income tax collections held by the state. The bill specifies that: (1) the balances remaining after making those transfers shall be used by the state to pay any refunds of county taxes for taxable years beginning before January 1, 2016; and (2) on January 1, 2019, any remaining balances shall be transferred to the county. The bill also makes technical corrections.

Effective Date: January 1, 2016.

Explanation of State Expenditures:

LOIT Account Balances: The bill requires the state to transfer to each county 95% of the balance in its LOIT account on February 1, 2016, and on November 1, 2016. The remaining 5% will be used to pay any LOIT refunds for taxable years before January 1, 2016. On January 1, 2019, the remaining balances will be transferred to the county and the accounts will be closed. The bill does not provide for the state to recover funds from counties that would have negative LOIT account balances at that time. It is unclear whether the counties would or would not have to pay those funds back to the state. A total of eight counties are estimated to have a negative LOIT account balance on December 31, 2013. These negative LOIT account balances total approximately \$5.3 M. The potential negative balances that may exist as of December 31, 2015, are unknown.

Department of State Revenue (DOR): This bill transfers the administration and collection of LOIT from the DOR to the counties that impose LOIT starting with the taxable year beginning on January 1, 2016. (Note: LOIT includes CAGIT, COIT, CEDIT, LOIT for property tax freeze, LOIT for property tax relief, and LOIT for public safety.) Currently, the DOR collects and administers LOIT for all counties. The DOR will be able to reallocate some dedicated staff to other functions. However, the cost savings from transferring LOIT collection and administration to the counties will likely be small. The DOR is still required to administer LOIT tax returns for the taxable years before January 1, 2016, and the DOR will still administer the state Individual Adjusted Gross Income Tax which is imposed on the same population.

State Budget Agency (SBA): The SBA will no longer be required to calculate the certified distributions of LOIT revenue. In addition, the SBA will no longer be required to produce all the reports associated with the collection and accounting of LOIT revenue. Staff and resources dedicated to these functions will be allocated to different tasks.

Explanation of State Revenues:

Summary of NET Local Impact: The net impact of this bill will vary by county.

(1) The bill makes the collection and administration of LOIT the responsibility of the counties with a LOIT beginning with taxable year January 1, 2016. Counties will have to dedicate and expend resources to collect LOIT revenue and to administer the tax. This will increase the overall operating costs of county governments. Currently, LOIT is administered by the state at no cost to the counties.

(2) The bill also eliminates the certified distribution process currently in place. The certified distribution process provides LOIT revenue collected by the state back to the counties. The certified distribution for a county in a particular calendar year is based on tax returns two years prior. By eliminating the certified distribution process, counties will begin to receive money directly from taxpayers. In the long run, revenue from current year direct collections should be equivalent to revenue that counties would receive under the current system.

(3) The bill requires the state to transfer 95% of the remaining balances in the county LOIT accounts on February 1, 2016, and November 1, 2016. These payments may offset the initial costs to begin administering LOIT in counties that have a LOIT account balance at that time. The remaining balances will be transferred to the county treasurers on January 1, 2019.

Explanation of Local Expenditures: Summary - This bill provides counties with the authority and responsibility to collect and administer LOIT. Under the bill, counties will either have to collect and administer LOIT or enter into a contract to provide the necessary services. This will increase the

administrative expenses of the counties imposing LOIT, requiring the staff and resources necessary to collect withholding payments from employers, collect quarterly estimated payments from taxpayers, process annual returns from taxpayers, issue refunds and assessments, and perform compliance activities. Since the counties have not previously administered an income tax, they will likely need to acquire additional resources to administer LOIT. The initial start-up costs will vary depending on each county's current resources and the administrative functions they can adapt to income tax administration. For some counties, the initial expenditures for staff and resources could be significant. Once the appropriate resources are in place, the annual collection cost as a percent of revenue is estimated to be 1.2% to 4.3%, with a minimum cost estimated at \$281,000 annually. Currently, the state bears all cost of collecting and administering LOIT for the counties. The table at the end of the document contains the estimated county collection cost.

Additional Information - This bill moves the collection and administration of LOIT from the DOR to each county that imposes LOIT. The bill requires the county treasurers to collect and administer:

- Estimated payments of LOIT from county taxpayers.
- Remittance by employers of LOIT withheld from employee wages.
- LOIT paid by taxpayers with annual tax returns.

The bill states that employers must remit wages withheld for LOIT purposes to the appropriate county treasurer. For example, if an Allen County business employed people living in DeKalb County, Adams County, and Allen County, the business would have to remit the correct withholding amounts directly to each county. The bill requires the county to receive the employer and employee withholding statements necessary to process LOIT returns and compute LOIT liabilities.

The bill states that county taxpayers will file their LOIT return with their county treasurer. The county treasurer must be able to provide the taxpayers with an appropriate form to fulfill this filing obligation. The county is required to process the return and any payment that was sent with it. If the taxpayer is due a refund, the county treasurer is required to issue it.

The county treasurer is required to administer LOIT as it exists in current law. In addition, the county treasurer will be held to similar standards as the DOR. For example, the county treasurer will be subject to the same timing parameters regarding refunds and interest. The bill requires a county treasurer to retain records of all tax returns and payments received for at least three years. There are three operational exceptions listed in the bill:

- Paid preparers are not required to file LOIT returns electronically with the county treasurers.
- Employers are not required to electronically remit withholding information and payments to the county treasurers.
- County treasurers are not required to crosscheck employer WH-3 withholding returns to individual W-2 forms.

The county treasurer is granted the authority to perform the tasks necessary to administer LOIT, including enforcement powers. The county treasurer will be able to issue assessments, employ collection techniques, operate audit programs, and levy penalties for this purpose. The responsibilities are the same as under current statute, but must be implemented by county treasurers and not the DOR.

Each county treasurer's office will incur additional expenses to administer LOIT. First, a county treasurer

may have initial expenses to acquire additional IT resources, print forms, notify employers across the state regarding withholding, and develop a returns processing system. Because of the confidential information contained on an income tax return, county treasurers likely will have to implement new security protocols. In addition, county treasurers will likely receive federal income tax information, so they will have to become compliant with the Internal Revenue Service (IRS) data integrity rules. After all the resources are in place, the annual collection cost as a percent of revenue is estimated to be 1.2% to 4.3% ,with a minimum cost estimated at \$281,000 annually.

The collection cost as a percent of revenue (collection cost ratio) will likely vary for each county. Due to economies of scale, a larger tax base combined with efficient use of technology could decrease the collection cost ratio. For example, the DOR has a collections cost ratio of approximately 0.40%, while the IRS has a collections cost ratio of about 0.5%. The estimated collections costs for the county treasurers are based on the collection costs of municipalities in other states that administer a local income tax.

Explanation of Local Revenues: LOIT Collections: Currently, LOIT is distributed by the state based on the certified distribution process performed by the State Budget Agency. The majority of the certified distribution for a particular calendar year is based on tax returns filed for a taxable year two years prior. As a result, there is a lag between the actual revenue collected from LOIT by the DOR and the basis of the LOIT certified distribution for a county. This bill eliminates the certified distribution process as of January 1, 2016. After January 1, 2016, counties will collect LOIT on a current-year basis through withholding payments by employers, quarterly estimated payments from taxpayers, and payments made with annual returns.

Currently, a county's certified distribution for CY 2016 would be based on the returns processed in FY 2015, 95% of which would be for taxable year 2014 and the balance for tax year 2013. Under the bill, counties would receive taxes actually paid in tax year 2016. While collections in 2016 may deviate from the amounts a county otherwise may have received under the certified distribution process, it is expected that revenue counties will receive in the long run under the bill will be equivalent to what they would receive under the current system.

LOIT Account Balances: The bill requires the state to transfer 95% of the remaining balances in the county LOIT accounts on February 1, 2016, and November 1, 2016. It is estimated that 84 counties will have positive balances in their LOIT accounts on December 31, 2013. These LOIT account balances total approximately \$312.2 M. The potential balances that may exist on February 1, 2016, are unknown

State Agencies Affected: Department of State Revenue; State Budget Agency.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: State Auditor's Database; LSA - LOIT: 1% Estimates of Certified Distributions; SBA, Local Option Income Tax Balance Report Estimated December 2013, November 20, 2014. City of Canton, Comprehensive Annual Financial Report for the Year Ended December 31, 2012. August 30, 2013; City of Akron, 2014 Budget Plan, June 10, 2014; City of Saginaw, MI, 2014-2015 Approved Budget, May 19, 2014; City of Battle Creek, Preliminary Budget Fiscal Year 2014-2015; City of Columbus, FY 2015 Budget, November 15, 2014; City of Toledo, 2015 Proposed Annual Operating Budget, November 14, 2014; U.S. Treasury Department, Internal Revenue Service - Budget in Brief FY2014, Document 9940 (Rev.4-2013) U.S. Treasury Department, Internal Revenue Service - Budget in Brief FY2015, Document 9940 (Rev.4-2013)

Fiscal Analyst: Heath Holloway, 232-9867.

Estimated LOIT Collection Cost by County

County	Collections & Admin. Costs		County	Collections & Admin. Costs	
	CY 2016	CY 2017		CY 2016	CY 2017
Adams	(\$327,000)	(\$338,000)	Lawrence	(\$403,000)	(\$416,000)
Allen	(\$3,231,000)	(\$3,325,000)	Madison	(\$1,133,000)	(\$1,168,000)
Bartholomew	(\$776,000)	(\$802,000)	Marion	(\$10,367,000)	(\$10,692,000)
Benton	(\$281,000)	(\$281,000)	Marshall	(\$344,000)	(\$356,000)
Blackford	(\$281,000)	(\$281,000)	Martin	(\$281,000)	(\$281,000)
Boone	(\$769,000)	(\$796,000)	Miami	(\$413,000)	(\$426,000)
Brown	(\$281,000)	(\$281,000)	Monroe	(\$915,000)	(\$952,000)
Carroll	(\$281,000)	(\$281,000)	Montgomery	(\$444,000)	(\$458,000)
Cass	(\$463,000)	(\$476,000)	Morgan	(\$1,188,000)	(\$1,213,000)
Clark	(\$1,320,000)	(\$1,363,000)	Newton	(\$281,000)	(\$281,000)
Clay	(\$302,000)	(\$311,000)	Noble	(\$385,000)	(\$399,000)
Clinton	(\$344,000)	(\$353,000)	Ohio	(\$281,000)	(\$281,000)
Crawford	(\$281,000)	(\$281,000)	Orange	(\$281,000)	(\$281,000)
Daviess	(\$314,000)	(\$326,000)	Owen	(\$281,000)	(\$281,000)
Dearborn	(\$281,000)	(\$281,000)	Parke	(\$281,000)	(\$281,000)
Decatur	(\$281,000)	(\$281,000)	Perry	(\$281,000)	(\$281,000)
DeKalb	(\$523,000)	(\$541,000)	Pike	(\$281,000)	(\$281,000)
Delaware	(\$574,000)	(\$590,000)	Porter	(\$691,000)	(\$717,000)
Dubois	(\$365,000)	(\$378,000)	Posey	(\$281,000)	(\$281,000)
Elkhart	(\$2,437,000)	(\$2,511,000)	Pulaski	(\$281,000)	(\$287,000)
Fayette	(\$281,000)	(\$281,000)	Putnam	(\$281,000)	(\$281,000)
Floyd	(\$672,000)	(\$688,000)	Randolph	(\$284,000)	(\$291,000)
Fountain	(\$281,000)	(\$281,000)	Ripley	(\$281,000)	(\$281,000)
Franklin	(\$281,000)	(\$281,000)	Rush	(\$281,000)	(\$281,000)
Fulton	(\$281,000)	(\$281,000)	St. Joseph	(\$2,882,000)	(\$2,966,000)
Gibson	(\$281,000)	(\$281,000)	Scott	(\$281,000)	(\$281,000)
Grant	(\$706,000)	(\$722,000)	Shelby	(\$331,000)	(\$336,000)
Greene	(\$281,000)	(\$281,000)	Spencer	(\$281,000)	(\$281,000)

County	Collections & Admin. Costs		County	Collections & Admin. Costs	
	CY 2016	CY 2017		CY 2016	CY 2017
Hamilton	(\$4,073,000)	(\$4,325,000)	Starke	(\$281,000)	(\$281,000)
Hancock	(\$978,000)	(\$1,006,000)	Steuben	(\$398,000)	(\$413,000)
Harrison	(\$281,000)	(\$281,000)	Sullivan	(\$281,000)	(\$281,000)
Hendricks	(\$1,771,000)	(\$1,861,000)	Switzerland	(\$281,000)	(\$281,000)
Henry	(\$298,000)	(\$308,000)	Tippecanoe	(\$1,169,000)	(\$1,213,000)
Howard	(\$733,000)	(\$756,000)	Tipton	(\$281,000)	(\$281,000)
Huntington	(\$365,000)	(\$375,000)	Union	(\$281,000)	(\$281,000)
Jackson	(\$413,000)	(\$429,000)	Vanderburgh	(\$1,108,000)	(\$1,139,000)
Jasper	(\$627,000)	(\$650,000)	Vermillion	(\$281,000)	(\$281,000)
Jay	(\$281,000)	(\$281,000)	Vigo	(\$688,000)	(\$706,000)
Jefferson	(\$281,000)	(\$281,000)	Wabash	(\$522,000)	(\$537,000)
Jennings	(\$281,000)	(\$281,000)	Warren	(\$281,000)	(\$281,000)
Johnson	(\$1,140,000)	(\$1,182,000)	Warrick	(\$281,000)	(\$289,000)
Knox	(\$281,000)	(\$281,000)	Washington	(\$281,000)	(\$281,000)
Kosciusko	(\$489,000)	(\$504,000)	Wayne	(\$488,000)	(\$501,000)
LaGrange	(\$291,000)	(\$303,000)	Wells	(\$358,000)	(\$367,000)
Lake	(\$4,427,000)	(\$4,543,000)	White	(\$281,000)	(\$281,000)
LaPorte	(\$605,000)	(\$625,000)	Whitley	(\$281,000)	(\$281,000)

* All estimates assume a cost of collection ratio of 2.8%